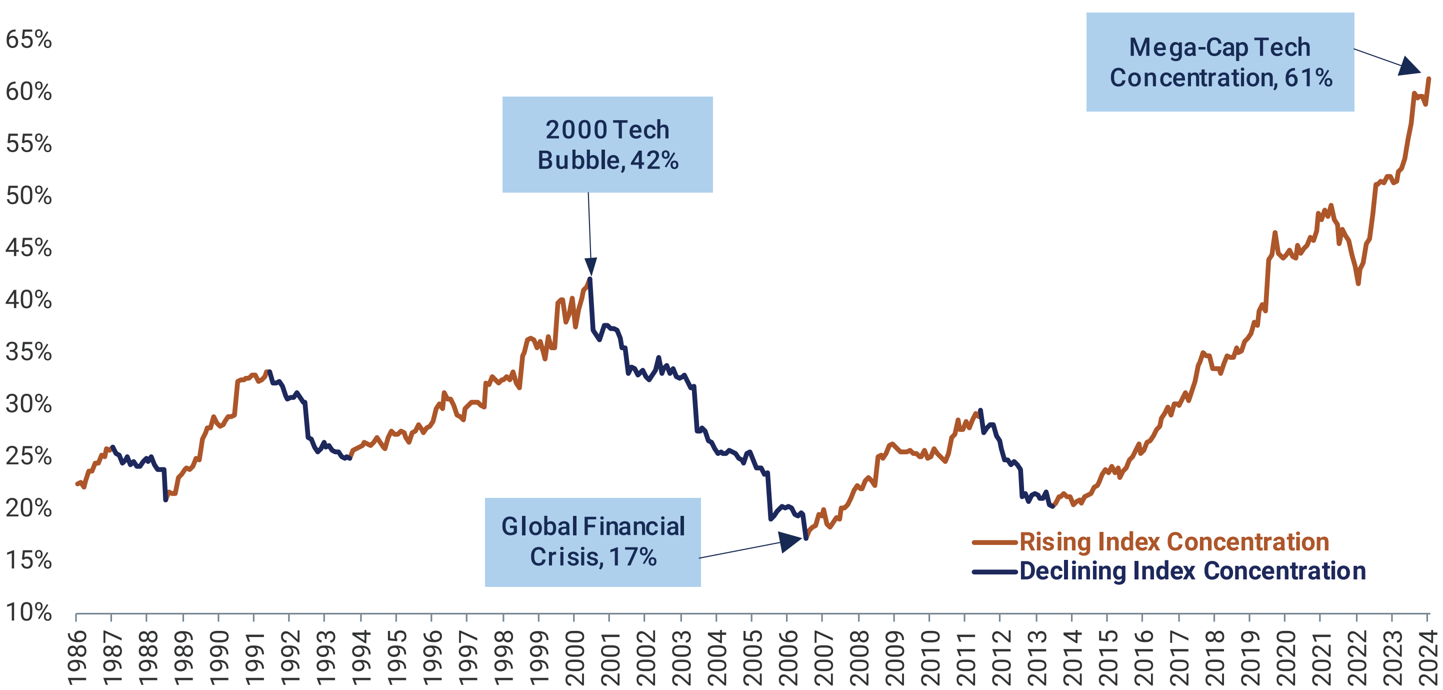
Active Manager Advantage: Opportunities in a Concentrated Market

The Russell 1000 Growth Index has appreciated meaningfully in recent years as a handful of mega-cap growth stocks have dominated the market and become large weights in the benchmark. This has made for a challenging period for active managers to generate outperformance, but OAM Research believes that the environment for stock picking may be turning.

The Rise of Mega-Cap Dominance: A New Concentration Peak

The Russell 1000 Growth Index has risen notably over the last decade, with the strongest gains coming in the last two years. As of December 31, 2024 the index generated a 19% annualized return over the last ten years, far greater than its long-term historical average and outpacing many active managers in the large cap growth category. The majority of the index gains have been driven by its top constituents, which have generated outsized returns in recent years and, as a result, have become large weights in the benchmark. The top ten constituents in the index have grown from a 17% weight in 2007 to 61% by the end of 2024. This is the most concentrated the Russell 1000 Growth Index has ever been, exceeding the index concentration reached at the peak of the Tech Bubble in 2000. With such a large weighting in just ten names, the index is not nearly as diversified as it has been in the past, and passive investors may not be receiving a properly diversified portfolio.

Russell 1000 Growth Index Concentration in Top 10 Names Rose to 61%
Weight of Top 10 Russell 1000 Growth Holdings Over Time (1987-2024)



Source: Morningstar Direct as of 12/31/2024
The Large Cap Growth active manager universe referred to in this piece was based off of the active managers in Morningstar's Large Cap Growth universe. These active managers were determined by starting with the managers in the Large Cap Growth Morningstar category and filtering out those that reported their management approach as "passive" and those that had "index" in the name. The average return of the peer universe was utilized when making statements regarding active manager performance relative to the Russell 1000 Growth Index.

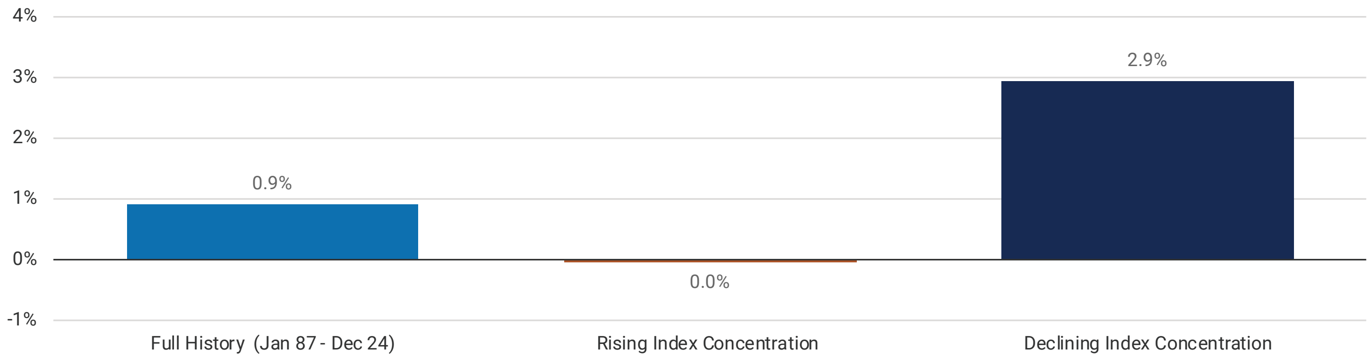
Lessons from History: Outperformance in Times of Change

With so much of the index concentrated in so few companies and with those stocks handily outperforming the remaining companies in the index, the relative returns of active managers during this period have been lackluster. Active managers that employ single stock sizing limits for risk management are typically unable to hold these stocks at the same weights as the index, making it nearly impossible for managers to match the gains of the benchmark. However, past occurrences of extreme index concentration have resulted in meaningful reversals, and historically that has been an attractive environment for active managers to generate excess returns. Following the burst of the Tech Bubble, active managers outperformed by an average of 3.4% per year over the following six years while the index concentration declined. Since the index's inception in 1987, active managers have averaged 2.9% outperformance per year during periods of declining index concentration. Since the index inception, the average active large growth manager has actually outperformed the Russell 1000 Growth Index by 0.9% per year, despite underperforming by 2.6% per year during the latest period of rising concentration since June of 2014.

Following the burst of the Tech Bubble, active managers outperformed by an average of 3.4% per year over the following six years while the index concentration declined.

Large Growth Managers Performed Better When Index Concentration Was Declining

Excess Return of Large Growth Peer Avg over R1000G (Annualized)



Source: Morningstar Direct as of 12/31/2024

While active manager performance in the large cap growth space has not met expectations recently, it is important to keep longer-term historical trends in mind when evaluating portfolios. OAM Research believes that skilled active managers that implement consistent investment processes possess the ability to generate alpha.

Due to the extreme concentration of the index today, we anticipate a more favorable environment for alpha generation lies ahead.

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This is only one factor of the many factors that should be considered when rolling over a 401(k) plan.

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